B4750-1

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

Friday
(Noon)

Sept. 25, 1981

The downward drift of short-term interest rates began to show signs of being arrested this week, amid indications that the Federal Reserve wants to avoid an excessive rate drop that might be reversed later on.

The most important evidence of that determination is the Fed's decision on Monday to change--effective October 1--the rules for application of the discount rate surcharge to large banks that are frequent borrowers from the Fed's discount window. Under the previous rules, large banks--i.e., those with deposits of $500 million or more--were subject to the surcharge if they borrowed in more than four statement weeks during a calendar quarter or in two successive weeks. The new rules replace the calendar quarter with a 13-week "moving quarter." Thus, if a bank borrows during more than four statement weeks in the period including the current statement week as well as the 12 previous statement weeks, it is subject to the surcharge. The surcharge is still applied in the second of the two successive weeks in which a bank borrows.

The significance of this change is that the four so-called "tickets" allowing banks to borrow at the basic discount rate do not "expire" at the end of the calendar quarter as under the old rules. For example, a bank that had not borrowed at all during the first six weeks of this quarter would have to borrow every other week during the remaining seven weeks in order not to lose a ticket at the quarter's end. As we have noted here several times before, the attempts of banks to utilize fully their borrowing privileges caused them to become significantly less aggressive in bidding for Federal funds--that is a major explanation for the roughly 3% decline in the funds rate since about the middle of the third quarter. The rule change should put a brake on the recent plunge of the funds rate by making banks more cautious in covering their reserves positions.

Interestingly, what attracted the most attention from financial market participants was the reduction of the surcharge rate to 3% from 4% announced simultaneously with the rule change. The meagerness of that rate cut disappointed some participants, who had hoped for a larger reduction. In fact, since virtually no banks were borrowing at the surcharge rate anyway, the rate cut made no difference operationally--though it might be said to hold out a prospect of slightly reduced rate pressures in any future increase of pressure on reserves positions. It appears that the cut served two main purposes. First, it was a gesture--largely symbolic--to Congress, which has been highly critical lately of high interest rates. The second, and more important, purpose was probably to offset some of the upward push on the funds rate that might be expected to follow from the new rule.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Market Yields

	9/25/81 (Noon)	Week Ago	Year Ago
Prime	19.50%	20.00%	13.00
Effective	9/22/81		
Discount	14.00	14.00	11.00
Federal Funds	14.00	15.75	11.88
Repurchase Agreements	13.50	14.13	11.50
U.S. Treasury			
Bills			
3 months	15.10	14.96	11.25
6 months	15.74	15.61	12.25
1 year	16.08	15.90	12.50
Coupon			
2 years	16.20	15.95	12.47
4 years	16.00	15.70	12.30
7 years	15.70	15.27	12.10
10 years	15.45	14.87	12.02
Long Bond	14.87	14.16	11.85
Negotiable Certificates of Deposit-Secondary Market			
1 month	15.00	16.15	11.80
3 months	15.90	16.40	12.10
6 months	16.70	16.75	12.65
1 year	16.50	16.65	12.75
Bankers Acceptances			
1 month	15.00	15.95	12.00
3 months	16.00	16.45	12.30
6 months	16.75	16.75	12.70
Eurodollars			
1 month	16.13	16.88	12.13
2 months	16.50	17.00	12.44
3 months	17.13	17.38	13.06
Commercial Paper-Prime Names			
Direct			
Finance Company			
1 week	12.00	14.50	11.75
1 month	14.25	15.38	11.50
3 months	14.25	15.50	10.75
Bank Holding Company			
1 month	14.75	15.50	11.25
Dealer Placed			
3 months	15.75	15.50	11.88
New A.A. Composite Utility Bond	17.75	17.15	13.75
Tax Exempts			
6 month	8.90	9.15	5.45
1 year A.A.A. Bond	8.75	9.00	6.00
5 year A.A.A. Bond	9.60	9.50	6.30
20 year A.A.A. Bond	11.50	12.65	8.60

This information is [illegible] market yields.
It should not be construed as an offering.
All yields are [illegible] to market.

[illegible] Trust Company • R.C.A. 232241
W.U.T. 62813 • Telex 12-9829

BEST AVAILABLE COPY